

Mercantile Law

Fifth Edition

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Fifth Edition by Denis Keenan

Pitman

PITMAN BOOKS LIMITED
128 Long Acre, London WC2E 9AN

PITMAN PUBLISHING INC
1020 Plain Street, Marshfield, Massachusetts

Associated Companies

Pitman Publishing Pty Ltd, Melbourne
Pitman Publishing New Zealand Ltd, Wellington
Copp Clark Pitman, Toronto

© Kenneth Smith and Denis Keenan, 1965
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Fifth Edition 1982
Reprinted 1982

British Library Cataloguing in Publication Data

Smith, Kenneth
Mercantile law.—5th ed
1. Commercial law—England
.I. Title II. Keenan, Denis
344.206'7 KD1629

ISBN 0-273-01769-1

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Text set in 10/11 pt Linotron 202 Times, printed and bound
in Great Britain at The Pitman Press, Bath

Preface

to fifth edition

Once again, this edition has been substantially rewritten and updated. In particular, the chapter on Company Law has been revised to include the Companies Act 1980. However, it was not possible to include the provisions of the Companies Act of 1981 in the text but the main changes that result from its enactment appear below.

PART 1—COMPANY ACCOUNTING AND DISCLOSURE

General provisions in respect of the form and content of accounts

The main features of the Act affecting the *form* and *content* of accounts are:

(i) a new schedule (Sch. 1) to replace Sch. 8 of the 1948 Act, listing disclosure requirements and introducing detailed rules for the content and format of accounts and the accounting principles and rules that must be followed.

(ii) A new statement of the statutory requirements in respect of the preparation of a company's accounts, the overriding requirement still being that the balance sheet and profit and loss must give a true and fair view.

Other provisions on accounts include:

An extension of the requirements of the Companies Act 1967 in respect of information to be provided in accounts about subsidiaries and other bodies corporate in which the company has significant shareholdings. Clause 3 extends s.4 of the 1967 Act and requires the reporting company to give in a note to the accounts information about companies in which it holds more than 10% of the share capital. Clause 4 requires a reporting company to give financial information about its subsidiaries and other bodies corporate in which it holds more than 20% of the share capital.

As regards *accounting exemptions*, under clauses 5–10 small companies are permitted to file only an abridged balance sheet. Such companies will, therefore, not be required to file a profit and loss account or a directors' report. A company will qualify to be treated as

a small company if it does not exceed more than one of the following thresholds:

Turnover £1.4 million;
Balance sheet total £0.7 million;
Employees 50.

Medium-sized companies are to be permitted not to include in modified accounts details of their turnover and gross profit margins. A company will qualify to be treated as a medium-sized company if it does not exceed more than one of the following thresholds:

Turnover £5.75 million;
Balance sheet total £2.8 million;
Employees 250.

These thresholds are also applicable to a group of companies taken together to determine whether the group may be treated as small or medium-sized for the purpose of its group accounts.

Companies in the following categories, regardless of size, are not eligible to be treated as small or medium-sized:

Public companies
Banking companies
Insurance companies
Certain shipping companies
Members of groups containing public, banking, insurance or shipping companies.

The banking, insurance, and shipping companies concerned are defined in Sch. 2 of the Act. However, the Act enables banking companies, insurance companies, and shipping companies (in each case as defined) to continue to prepare accounts broadly on the basis of existing statutory requirements, including the present Sch. 8 of the Companies Act 1948, rather than comply with the new provisions of the 1981 Act.

As regards *publication of accounts*, Clause 11 deals with publication otherwise than by delivery to the Registrar. Published full or exempt accounts must be accompanied by any group accounts, and they and any group accounts must be accompanied by the auditors' report. Published abridged accounts must state that they are not full accounts and whether full accounts have been delivered to the Registrar. A company may not publish the full auditors' report with abridged accounts but must say whether such a report has been prepared and whether it is qualified.

Clause 12 of the Act creates a new regime for *dormant companies*—those companies eligible to be treated as small companies and in respect of which no significant accounting transaction has taken place during the period in question. Such companies will be relieved from the requirement to have their accounts audited; accounts delivered to the Registrar of Companies must state that the company is dormant.

As regards the *directors' report*, Clause 13 requires it to contain: a fair review of the development of the business of the company and its subsidiaries during the year, and of the position at the end of it; information about important events occurring since the end of the year; likely future development activities.

Clause 14 requires information on the acquisition by a company of its own shares to be disclosed in the report instead of, as now, in the notes. Clause 15 requires any inconsistency between the directors' report and the accounts to be stated in the auditors' report. Clause 16 removes the requirement for certain companies to give details of exports in the report.

PART II—COMPANY NAMES AND BUSINESS NAMES

Company names

Prohibition of registration of certain names

The more important provisions are:

Under Clause 22 a company will not be registered with a name which is the *same* as a name appearing in the index kept by the Registrar or which in the opinion of the Secretary of State is offensive, or which the Secretary of State thinks will give the impression that the company is connected with central or local government.

Under Clause 23 the Registrar must keep an index of the names of all UK registered companies and all overseas companies with a place of business in the UK.

Under Clause 24 the Secretary of State can direct a company to change its name within 12 months of registration if by inadvertence a name which is prohibited has slipped through.

The above provisions replace the complex rules of Practice Note 1972.

Business names

The Registration of Business Names Act 1916 is repealed and the procedure for registration of business names will no longer apply. Instead the following provisions will come into the law:

(1) The names of the proprietors of a business are to be stated on all business letters, invoices and receipts, and written demands for the payment of debts, and must appear in a prominent position in any premises where business is carried on.

(2) The above provision, which is in Clause 29, does not apply to firms with more than 20 partners. The documents referred to in Clause 29 above must give the firm's principal place of business and state that a list of partners is available for inspection there. Any person may inspect that list.

PART III—SHARE CAPITAL

Relief from s.56 of the 1948 Act (share premium account)

(1) The case of *Shearer v Bercain* (1980) had the effect of locking up precombination profits in mergers and acquisitions.

(2) The provisions of the Companies Act 1981. Under Clause 85 pre-combination profits will be distributable where there is an agreed merger between two or more companies by a share-for-share exchange so that the acquiring company obtains at least 90% of the equity in the other company or companies. Thus agreed mergers like Cadbury Schweppes and Bass Charrington will not in future give rise to difficulties in regard to the capitalization of pre-combination profits.

Under Clause 36 internal group reconstructions, e.g. where a new holding company acquires other companies as subsidiaries on a share-for-share exchange, will leave pre-combination profits in the subsidiaries as distributable. This Clause will be of particular importance to private companies which wish to go to the unlisted securities market but need to be reconstructed under a parent limited company in order that the shares can be offered to the public.

Under Clause 37 there is retrospective relief for transactions entered into on or after the 4 February 1981.

It is important to note that there is no relief in the acquisition situation, i.e. where there is an aggressive take-over by a predator company where the board of the victim company is unwilling and the offer is made direct to the shareholders. In this situation pre-combination profits are capitalized under s.56 of the 1948 Act as before.

Finance assistance for acquisition of shares by companies

Under Clause 40 a company, public or private, may provide financial assistance for the purchase of its own shares or those of its holding company *if this is incidental to a bona fide transaction and does not have acquisition as its main aim*.

Thus where company A sells goods to company B and company A uses the money which company B pays to it to buy shares in company B, there can now be no suggestion that there is financial assistance which is forbidden by the law. There were indications in *Belmont Finance v Williams Furniture* (1979) that s.54 of the 1948 Act, which is the current provision, was wide enough to produce this undesirable result.

Clause 40 also facilitates management buy-outs, i.e. the disposal of a company to its management who buy the shares in the company with a loan from the company's funds. It will also assist banks when lending to companies in the sense that if there is a management buy-out by use of the company's funds where the bank has lent the

company money, then the bank's loan will not be void, whereas previous legislation would have suggested that it might be.

Clause 41 allows private companies to give assistance for the purchase of shares *for any purpose* if the members so resolve by special resolution and the directors give a statutory declaration of solvency which is reported on favourably by the company's auditors.

Power of company to issue redeemable shares

Clause 43 gives companies power to issue redeemable equity shares. S.58 of the 1948 Act allows only the redemption of preference shares.

The redeemable equity shares must be fully paid on redemption and may be redeemed out of distributable profits or the proceeds of a fresh issue of shares, any premium on redemption being paid from distributable profits. Where redemption is out of profits a capital redemption reserve fund must be opened, as is the case with redeemable preference shares under s.58 of the 1948 Act.

Purchase by a company of its own shares

Under Clause 44 all companies may, if authorized by their articles, purchase from their members their own shares. This cannot be done, however, if the company would be the sole member of itself in terms of the holding of equity shares. The purchase of the shares may be out of the proceeds of a fresh issue or out of profits, as in Clause 43 above.

Clauses 45–47 deal with purchases by a company of its own shares on the stock market or in off-market deals from authorized dealers. Since such purchases may affect the market price, members in general meeting must authorize the purchase so that they are at least informed that the company intends to buy and that this may disturb the price for a while.

Clause 48 requires disclosure to the Registrar of any shares purchased by the company within 28 days.

Clauses 50–54 allow private companies to buy their shares from capital, provided that the members approve this by special resolution and the directors give a statutory declaration of solvency which receives a favourable report from the company's auditors. The directors must also put a notice in the *Gazette* to the effect that they intend to purchase some shares from capital. Members not voting for the special resolution and any creditor can object to the court within five weeks and ask the court to cancel the arrangement. Furthermore, if the company is wound up within 12 months the members whose shares were purchased out of capital and the directors are liable to repay that capital to the company.

PART IV—DISCLOSURE OF INTERESTS IN SHARES—CONCERT PARTIES

Present powers

Ss 172–174 of the 1948 Act allow the Department of Trade to conduct an investigation into the ownership of a company's shares. Ss 33 and 34 of the 1967 Act, as amended by s.26 of the 1976 Act, require disclosure of substantial interests by shareholders with a threshold at 5%. S.27 of the 1976 Act allows directors to ask members whether they are nominees.

These provisions are ineffective against concert parties, i.e. a group of people who vote and act in concert in every way and yet hold, e.g. 4.9% of the voting shares of a company so that disclosure by each individual is not required.

New provisions

These state much of the existing law but seek to increase its effectiveness.

The new provisions create an obligation to notify a public company of interests in its voting shares. The threshold is 5% and disclosure must be made at this point followed by disclosure of increases or decreases in the holding of more than 1%. The company must be informed within five days and must record the information in a register of substantial interests. Failure to make the disclosure results in a fine or imprisonment, or both.

As regards concert parties, a concert party is defined as an agreement (whether legally binding or not) to acquire interests in shares in a public company. Such concert parties are obliged to tell the company the collective holding of each concert party. They may appoint an agent for this purpose but if not, all the members of the concert party are liable to notify the company and they also have a duty to tell each other member of the concert party what their holding is. The disclosure requirements are at 5% and within five days as above.

A public company may inquire, as before, into the ownership of its shares but there are now new penalties. The company may apply to the court for the restrictions set out in s.174 of the 1948 Act to apply, e.g. no dividends to be paid, no votes to be exercised, no transfers to take place, and there are also criminal penalties for failure to reply to the company.

Because the directors may not take up the inquiry provisions referred to above, a member or members holding 10% or more of the paid up voting capital may exercise the power of inquiry and may ask the court to place the restrictions of s.174 on shares where replies are not received or are unsatisfactory.

PART V—MISCELLANEOUS

Investigations

The main provisions here are to allow a company to apply to have its affairs investigated without need for a resolution of the members. Thus the board could apply on behalf of the company for an investigation. Furthermore, the Act gives inspectors power to examine directors' bank accounts where they have reason to believe that such accounts may have been used in connection with certain offences under the Companies Acts, e.g. the payment of undisclosed emoluments.

The Act extends to magistrates the power to disqualify directors for up to five years from taking part in the management of a company and lengthens the period for which the High Court may disqualify from five years to fifteen years.

The Act also provides for criminal liability for fraudulent trading under s.332 of the 1948 Act, whether or not the company is in liquidation. There is no change in the civil aspects of s.332 under which a person may become liable for the debts of the company if he is engaged in fraudulent trading with it.

A new clause added to the Act at a late state in the Commons allows any company to make a loan to a director up to £2500 without any reason or resolution but disclosure of the amount is required in the accounts.

Of cases before the courts since the text was written, the decision of the House of Lords in *National Carriers v Panalpina (Northern) Ltd* [1981] 1 All E.R. 161 is worthy of note. In that case the House of Lords decided that a lease can be frustrated and what is said in the text on page 76 needs to be looked at in the light of this decision. National Carriers leased a warehouse to Panalpina for ten years but the Hull City Council closed the only access to it because a listed building nearby was in a dangerous condition. The closure was for twenty months and Panalpina refused to pay the rent during this time. The House of Lords decided that they must pay the rent. A lease, they said, could be frustrated but twenty months out of ten years was not a sufficient interruption.

The inclusion of graded questions with outline answers and tutorial problems is designed to assist the teacher in the testing of the student's understanding. The setting of past examination questions in students' tests presents some difficulties, at least in the earlier stages of a course, since such questions often require a greater knowledge of the syllabus as a whole than the student can be expected to have at a particular stage of study. The materials included in Appendix B and Appendix C enable the teacher to test the progress of a student after the teaching of a topic, e.g. Contract, or even after the teaching of a mere section of a topic, e.g. Offer and Acceptance.

In the preparation of this edition the publishers and I have received the invaluable assistance of my wife who has prepared and edited the typescript, the indexes and the proofs, together with the general

organization of sources of research for new material since the last edition. Thanks are also due to Eric Dalton of Pitman Books, and also The Pitman Press for their assistance in processing the typescript and the proofs.

Once again, I would like to acknowledge the contribution of my students who have in discussion caused me to recognize the inadequacy of my exposition of some areas of law covered in this text which are now much improved, I feel, because of their comments.

For the errors and omissions I am, of course, solely responsible.

Maenan, Gwynedd
November 1981

Denis Keenan

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1 The law of contract

A contract may be defined as an *agreement* enforceable by the law between two or more persons to do or abstain from doing some act or acts, their intention being to create legal relations and not merely to exchange mutual promises.

THE FORMATION OF CONTRACT

In order to decide whether a contract has come into being it is necessary to establish that there has been agreement between the parties. In consequence it must in general be shown that an offer was made by one party (called the offeror) which was accepted by the other party (called the offeree).

Offer

An offer may be made to a particular person, or in some cases, to the public at large. An offer to the public at large can only be made where the contract which eventually comes into being is a unilateral one, i.e. where there is a promise on one side for an act on the other. An offer to the public at large would be made, for example, where there was an advertisement offering a reward for services to be rendered, such as finding a lost dog, and see also *Carlill v Carbolic Smoke Ball Co.* 1893.¹

Offer distinguished from invitation to treat

An offer capable of being converted into an agreement by acceptance must consist of a definite promise to be bound provided that certain specified terms are accepted, and not a mere offer to *negotiate*. The distinction is sometimes expressed in judicial language by the contrast of an 'offer' with that of an 'invitation to treat'. The distinction may be considered under the following headings—

(1) *Auctions*. The advertisement of an auction is not an offer to hold it. (*Harris v Nickerson* 1873.)² At an auction the bid is the offer; the auctioneer's request for bids is merely an invitation to treat. The sale is complete when the hammer falls and until that time any bid

may be withdrawn. (s.57(2), Sale of Goods Act 1979.) However if *dicta* in *Warlow v Harrison* (1859) 1 E. & E. 309 are correct, the addition to the advertisement of an auction sale of the two words 'without reserve' converts it into an offer; presumably to the public at large, that the sale will in fact be subject to no reserve price. If in these circumstances the sale is actually held and a prospective purchaser makes a bid, he accepts the offer of a sale 'without reserve' and the auctioneer, if he then puts a reserve price on any of the lots, is liable to an action for breach of his undertaking that the sale would be without reserve, though it should be noted that the goods in question will not have been sold unless the auctioneer's hammer has fallen.

(2) *Price lists, catalogues.* The issue of a tradesman's circular or catalogue advertising goods for sale is usually regarded as a mere attempt to induce offers, not an offer itself. The same is true of advertisements to sell goods inserted in newspapers or periodicals. (*Partridge v Crittenden* 1968.)³

(3) *Price tickets.* The display of an article with a price on it in a shop window, or on the shelves of a self-service store, is merely an invitation to treat. It is not an offer for sale, the acceptance of which makes a contract. (*Pharmaceutical Society of Great Britain v Boots Cash Chemists Ltd* 1953.)⁴

(4) *Negotiations for the sale of land.* The same principles are applied, with perhaps this difference, that in the case of a sale of land which involves the adjustment of so many matters of detail, e.g. finding out whether the seller is the owner, the court is likely to regard a communication as an invitation to treat unless the intention to contract is very clear and not in the least casual. (*Harvey v Facey* 1893.)⁵

(5) *Company prospectus.* A prospectus issued by a company in order to invite the public to subscribe for its shares (or debentures) is an invitation to treat so that members of the investing public offer to buy the securities when they apply for them and the company, being the acceptor, will only accept that proportion of public offers which matches the shares or debentures which the company wishes to issue. If there are more offers than shares the issue is said to be over-subscribed.

Acceptance

Once the existence of an offer has been proved the court must be satisfied that the offeree has accepted otherwise there is no contract. The problems arising are considered under the following headings—

(1) *The person who accepts must have seen the offer.* Thus if B has found A's lost dog and, not having seen an advertisement by A

offering a reward for its return, returns it out of goodness of heart, B will not be able to claim the reward. However, as long as the acceptor is aware of the making of the offer his motive in accepting it is immaterial. (*Williams v Carwardine* 1843,⁶ and see *Carlill's case*.¹)

(2) *Effect of acceptance 'subject to contract'*. Acceptance must be absolute and unconditional. One important form of conditional assent is an acceptance 'subject to contract'. The law has placed special significance on these words and they are always construed as meaning that the parties do not intend to be bound until a formal contract is prepared. (*Winn v Bull* 1877.)⁷

(3) *Counter offer*. A counter offer is a rejection of the original offer and has the effect of cancelling the original offer. (*Hyde v Wrench* 1840.)⁸ However, the communication must amount to a counter offer. Thus where it appears that the offeree is merely seeking further information before making up his mind, his request for information will not destroy the offer. (*Stevenson v McLean* 1880.)⁹

It should be noted, however, that the counter offer may be accepted by the original offeror. The above principles of contract law are of increasing importance because of the modern commercial practice of making quotations and placing orders with conditions attached, so that the terms and conditions of the contract which may eventually be made may not be those which the original offeror put forward, since these may have been changed as a result of a 'battle of forms' between the parties. For an illustration see *Butler Machine Tool Co. Ltd v Ex-Cell-O Corporation (England) Ltd* (1979).¹⁰

(4) *Acceptance in the case of tenders*. It is essential to understand what is precisely meant by 'accepting' a tender since different legal results are obtained according to the wording of the invitation to tender. If the invitation by its wording implies that the potential buyer *will* require the goods, acceptance of a tender sent in response to such an invitation results in a binding contract under which the buyer undertakes to buy all the goods specified in the tender from the person who has submitted it. On the other hand, if the invitation by its wording suggests that the potential buyer *may* require the goods, acceptance of a tender results in a standing offer by the supplier to supply the goods set out in the tender as and when required by the person accepting it. The use of the word *may* indicates a vagueness in the requirements of the purchaser which prevents a contract for the whole of the goods coming into being. Under the standing offer each time the buyer orders a quantity there is a contract confined to that quantity; but if the buyer does not order any of the goods set out in the tender, or a smaller number than the supplier quoted for, there is no breach of contract. If the person submitting the tender wishes to revoke his standing offer he may do so except insofar as the buyer has already ordered the goods under the tender. These must be supplied or the tenderer is in breach of contract. (*Great Northern Railway v Witham* 1873.)¹¹